

Expected Topics to be covered in Proposed and Interim Regulations

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Q: What gains are eligible for deferral?

- Form 4797 Instructions have been updated to provide that only gain in excess of the depreciation recapture amount that is invested in a QOF qualifies for the temporary deferral of gain. This implies that gain from depreciation recapture is not eligible for deferral.

Q. What gains are eligible for deferral? (cont.)

Similar to the statute, Form 4797 instructions refer to both “gain” and “capital gain” as follows (emphasis added):

*Deferral of Gain Invested in a Qualified Opportunity Fund: If you realized gain from an actual or deemed sale or exchange with an unrelated person and, during the 180-day period beginning on the date the gain is realized, you invested any portion of the gain in a Qualified Opportunity Fund (QOF), then you may be able to elect to temporarily defer such eligible **capital gain** that would otherwise be includible in the current year’s income. If you make the election, the eligible **capital gain** is included in taxable income only to the extent, if any, the amount of realized gain exceeds the aggregate amount invested in a QOF during the 180-day period. For more information, see section 1400Z-2.*

Q. Which taxpayers are eligible to defer gain?

- Form 1065 Schedule D instructions state that a taxpayer should report the deferred gain as a negative number on Form 8949
 - Form 1065 is the partnership return – implies that a partnership with gain can elect at the entity level to invest that gain in a QOF
- Need clarification that a partner can reinvest its K-1 share of *partnership* gain
 - related Qs re: timing of such reinvestment.
- Also need clarification whether a taxpayer with a gain eligible for deferral under 1400Z can invest in a partnership, which in turn, invests in a QOF within 180 days and still qualify for the 1400Z benefits (feeder partnership concept).

Q: Can a new Fund have a grace period before it is required to satisfy all of the requirements?

- A QOF must hold at least 90 percent of its assets in qualified opportunity zone property, determined by the average of the percentage of qualified opportunity zone property held in the fund as measured-
 - on the last day of the first 6-month period of the taxable year of the fund, and
 - on the last day of the taxable year of the fund.
- What counts as the last day of the first 6-month period of the taxable year of the fund in the initial year of the fund – especially when the partial year is < six months?

Q: Will it be possible for a Fund to receive significant capital and then launch a significant project that requires a substantial ramp-up period? Where and how working capital may be held for projects requiring a substantial ramp-up period?

- Statute explicitly states that Treasury guidance is needed to provide reasonable time for an Opportunity Fund to reinvest the return of capital from the sale of investments in Opportunity Zone Property. Likewise, Opportunity Funds need adequate time to assemble and underwrite initial Opportunity Zone Property investments.
- NMTC Program provides a 12 month period to invest a QEI in a project.

Related Q: the question of a grace period also exists for a QOZB

- Requested:

A partnership or corporation will be deemed to be an Opportunity Zone Business if the Opportunity Fund reasonably expects, at the time the Opportunity Fund invests in the partnership or corporation, the partnership or corporation will become an Opportunity Zone Business.

Related Q: If the Fund is investing directly in QOZBP, or if a QOZB is investing in QOZBP, are cash reserves held for the acquisition and/or improvement of property considered non-qualified financial property? The statute seems to contemplate that a “substantial improvement” can reasonably be expected to take up to 30 months, therefore we would hope cash held to fund such planned improvements would be treated as QOZBP for up to 30 months.

Q: How will a Fund value its assets for purposes of the QOFs 90% test?

- Cost basis?
 - Tax basis?
 - FMV?
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- Similar Q for how a QOZB values its tangible property for “substantially all” requirement.

What constitutes original use for land? Is it possible for Land to qualify for original use?

- Original use of land in the zone - will never be the case.
- If substantially improved, does the land value get treated as qualified along with the improvements or is it a separate asset that can never be QOZBP?
- Question applicable to both OF 90% asset test and to QOZB's "substantially all" tangible property test.

Q: What is the definition of substantially all? Specifically questions around substantially all of assets required to be purchased after 2017.

- Similar substantially all standards in other place-based tax incentive statutes have been interpreted to mean 70% -85%

Q: Will partnership leverage give rise to a separate deemed contribution?

- There is confusion as to whether a partner's share of Opportunity Fund liabilities are considered a separate investment, thereby limiting the amount of gains that are eligible for exclusion under the ten-year hold benefit.
- This confusion stems from the fact that under IRC §752, any increase in a partner's share of the liabilities of a partnership, shall be considered as a contribution of money by such partner to the partnership.
- If treated as a separate investment, the appreciation in value allocable to the "debt investment" would not be eligible for 1400Z benefits.

Q: May a taxpayer elect to avoid gain on a QOF investment after an opportunity zone destination has expired in 2028.

- Question suggests that there is uncertainty as to whether appreciation occurring after the OZ designations expire will be eligible for the basis step up afforded investments held for 10 years or more.